PUBLIC VERSION

Before the
COPYRIGHT ROYALTY BOARD
LIBRARY OF CONGRESS
Washington, D.C.

In the Matter of	)	
Mechanical and Digital Phonorecord Delivery Rate Adjustment Proceeding	)	**Docket No. 2006-3 CRB DPRA**

TESTIMONY OF KYLE JOHNSON

1. My name is Kyle Johnson. I currently employed as Vice President of AOL LLC ("AOL"). I submit this testimony in connection with the Written Direct Statement of the Digital Music Association ("DiMA") in the above-captioned proceeding for setting rates and terms for the making and distribution of digital phonorecord deliveries ("DPDs").

2. I have been employed by AOL since June 1999 and have held my current position at AOL since November 2006. From March 2006 I was the Executive Director of Programming and Business Development. My responsibilities are providing business development support for the groups within AOL that (i) select and acquire music and other media content for distribution by AOL, (ii) program various entertainment distribution channels operated by AOL, and (iii) acquire companies with products or services that will enhance the competitive success of AOL in the distribution of entertainment products.

3. Prior to serving as Executive Director of Programming Business Development of AOL, I served as an Assistant General Counsel of AOL. In that position I was responsible for providing legal support for AOL's programming organization, including AOL's music distribution business.

4. I have a law degree from the College of William and Mary.

5. The following testimony is based on my personal knowledge and information made available to me in the course of performing my duties at AOL. To the extent that these statements are made on my personal knowledge, they are true. To the extent that they rely on information I have obtained from the business records of AOL and its affiliates, these records were made by employees of AOL with knowledge of the facts in the regular course of their business duties or were received by AOL from third parties and relied upon by AOL in the conduct of its business activities.

I. SUMMARY

6. AOL has sought to provide digital music offerings that appeal to the broad range of customers and potential customers in the marketplace. We have experimented with various business models: advertising-supported pre-programmed streaming, subscription-based pre-programmed streaming, subscription-based streaming on-demand, subscription-based limited ("tethered" or "conditional") downloads to personal computers ("PCs") and portable devices, and permanent downloads to subscription and non-subscription customers. Our goal has been to create an environment that respects

copyrights and in which writers, publishers, performers, record labels, and customers all benefit.

7. Unfortunately, AOL has determined that under the current market constraints, the challenges involved in providing these benefits cannot be overcome in a way that also is beneficial to AOL's shareholders and merits additional ongoing investment. AOL has therefore concluded that it will withdraw from the subscription music business as soon as we are able to find a buyer for that business.

8. The rate set in this proceeding will apply to AOL MusicNow retroactively. Thus, I submit this testimony to inform the Board as to the difficulty of making this market work and the importance of making sure costs stay reasonable and as low as possible during this early, start-up stage.

II. AOL HAS CONCLUDED THAT ADDITIONAL INVESTMENT IN THE DIGITAL MUSIC BUSINESS IS NOT THE BEST USE OF SHAREHOLDER RESOURCES

9. AOL is a majority-owned subsidiary of Time Warner, Inc., a global media, publication, communications and entertainment business, which reported revenues of $43.6 billion in 2005. AOL operates a leading network of web brands and the largest Internet access subscription service in the United States, with 25.5 million total AOL brand subscribers in the U.S. and Europe at the end of 2005. In 2005, AOL reported total revenues of $8.283 billion, $1.899 billion in Operating Income before Depreciation and Amortization and $1.177 billion in Operating Income.

10. AOL started offering an AOL-branded pre-programmed streaming music service to the members of its on-line service in 2001, when it launched Radio@AOL for AOL members. The service was later renamed to AOL Radio, and in July 2005, a web version of AOL Radio was introduced for non-members. AOL Radio joined with XM Satellite Radio in 2005 to offer a selection of XM Satellite Radio channels on AOL Radio.

11. AOL entered the subscription music market in 2003, offering a music download store on its membership-based service ("MusicNet@AOL"). Subscribers paying $8.95 per month received unlimited streaming and on-demand downloading of approximately 600,000 DPD tracks to an Internet-connected portable computer ("PC") for listening on that device for so long as they maintained their MusicNet@AOL subscription. MusicNet@AOL subscribers were not permitted to transfer their DPDs to other devices or to create a CD or other playable format. Subscribers who wished to listen to downloaded music on another device were required to purchase individual music tracks for $.99 each for burning directly to a CD. Portable players were not supported. By the end of March 2004, MusicNet@AOL had only 250,000 subscribers.

12. In November 2005, AOL Music acquired digital-music subscription company MusicNow (formerly FullAudio Corporation) from Circuit City, Inc. and introduced a web-based, full-service digital music service, AOL Music Now. AOL Music Now enabled AOL to offer a suite of music-based services designed to appeal to

the broadest possible range of music tastes and purchasing preferences. AOL Music Now provides subscription music services as well as simple permanent downloads to users.

13. We have determined that the subscription music business does not justify the projected need for ongoing additional investment. The availability of illegal music for free on the Internet makes it very difficult to charge customers for music services in the marketplace. Moreover, there are significant ongoing costs to market the service, acquire new content, access new platforms for delivering the service, and stay on top of market trends. As a result, despite the range of features we make available on AOL Music Now, we have been unable to attract sufficient customers to make the business profitable, especially given the substantial marketing opportunity costs we incur promoting the service on the company's other platforms. In this extraordinarily challenging business environment, the success of a music venture such as AOL Music Now is not assured.

14. [redacted]

15. The costs of running the business have exceeded revenues and are projected to exceed revenues into the future. We believe that a profitable subscription music business requires at least 1 to 1.5 million subscribers. We have not been able to achieve nearly that number, despite having access to the massive promotional engine provided by our online service. It does not make sense to invest more in this business, which we do not expect to become profitable within a reasonable period of time.

VI. CONCLUSION

16. In light of the foregoing, I believe that the Board should set royalties in a manner that takes into account the very fragile stage of the market. A rate set as a percentage of revenue would best allocate risks and rewards among content creators and services trying to reach consumers. The revenue base should be defined as DiMA

proposes to assess solely those activities related to the use of the license: the purchase of the permanent download or the plays made by subscribers of tethered downloads offered by the licensee.

17. A rate of 4.1% of revenues for permanent downloads and 4% of revenues for conditional downloads would reflect the extremely competitive and difficult business environment and the need to create incentives for continued investment and reduce entry barriers. Such a rate would also be consistent with investments made to date, the benefits to artists and songwriters that subscription services provide, and the risky business environment. There is no question that per-copy, per-stream or per-user minimum fees would have led to even earlier exit from this market by AOL and would create substantial barriers to any potential new entrant. Minimum fees do not make sense in a market where consumers have immediate access to free alternatives and the business model to succeed has not yet been established.

18. For all of these reasons I support the rates and terms proposed in DiMA's Written Direct Statement.

I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge, information and belief:

Kyle Johnson

October 28, 2006

Date

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This exhibit contains restricted information that is subject to a confidentiality agreement and has been redacted from the publicly filed version